Court: Cigarette makers still owe Phase II funding
Kentucky, 13 other states may benefit
Messenger Inquirer
08/20/05
From staff and wire reports

RALEIGH, N.C. -- A federal tobacco quota buyout doesn't free cigarette makers from having to pay $424 million to growers in 14 states as part of 1998's multibillion-dollar anti-smoking settlement, North Carolina's Supreme Court ruled Friday.

The ruling, which reversed a lower court's decision, was welcomed by cash-strapped tobacco farmers who had counted on the so-called Phase II money to pay for materials and equipment.

"I'm going to take it to the bank and pay some money I owe, and that's the honest truth," said Sam Crews, president of the Tobacco Growers Association of North Carolina, who stands to receive $60,000 as a result of the ruling.

An attorney representing the four cigarette makers involved in the deal -- Philip Morris USA, R.J. Reynolds Tobacco, Lorillard Tobacco and Brown & Williamson -- did not immediately return calls seeking comment. A spokesman for R.J. Reynolds declined to comment on the company's next step.

Kentucky's General Assembly this year provided $114 million in June to make up for most of the Phase II payment to Kentucky growers and quota holders. State officials expect to recoup the money with Friday's court order.

Kentucky Attorney General Greg Stumbo said: "The interest and penalties will increase the overdue payments to at least $124 million. ... That is money that Kentucky sorely needs."

The money for the Phase II payments was taken from Kentucky's Agricultural Development Fund, which was set up to promote farm diversification. Keith Rogers, executive director of the governor's agricultural policy, said the money returned to the state will reimburse the development fund.

"The first $114 million of any funds that come to the state, that will relieve the Agricultural Development Fund from any bond payments -- and the cash portion taken from the fund, we'll get that back," Rogers said.

Legislators transferred $27 million from the fund to finance $87 million bonds for the Phase II payments. In addition, $9.2 million would have been drawn from the fund annually to make bond payments.

"This is a big win, not only for all the states involved, but for us, because it puts that money back into the Agricultural Development Fund ... and it doesn't hurt us over the next 20 years of making that bond payment," Rogers said.

Sen. David Boswell, a Sorgho Democrat and a member of the Senate agriculture committee, said the ruling will help legislators, who no longer have to worry about replacing dollars removed from the development fund for Phase II payments.

"I felt comfortable that ruling would come down," Boswell said. " ... I was pretty uneasy taking that money out in the first place, but I felt a stronger obligation to the farmers."

The Lexington-based Burley Tobacco Growers Cooperative Association had kicked in an extra $10 million on top of the $114 million provided by the state. The cooperative will not be get a refund, despite the latest court ruling.

"We agreed that we didn't want anything back," co-op spokesman Daniel Green said. "We wanted to get this money out to growers and quota holders, who desperately needed it making the transition to the new market."

Federal statistics show that planted acreage of flue-cured tobacco in Virginia fell 40 percent from last year, and Kentucky's first burley crop since the buyout is expected to produce the smallest harvest in nearly 80 years.

Rod Kuegel, a Daviess County farmer and former president of the burley cooperative, said the ruling is important across the "burley belt."

"There was a lot more affected than just Kentucky farmers," Kuegel said. "There are a lot more farmers that didn't get paid than did. ...

"Kentucky farmers benefit from this because where did that money come from? It came from money for (diversification)," Kuegel said.

The payments stem from 1998's $206 billion settlement of anti-smoking lawsuits filed by 46 states against the cigarette makers. In the wake of that settlement, the tobacco companies agreed to a second part of the deal -- Phase II -- which would pay tobacco growers and quota holders $5.1 billion over 12 years to compensate them for reduced tobacco demand.

That agreement provided for a reduction or stop in the payments if the losses were made good in some other way, such as the $10.1 billion tobacco-quota buyout approved by Congress last year to end the Depression-era price support system.

Attorneys for tobacco-growing states argued the companies weren't relieved of making the Phase II payments to growers for 2004 until they started making buyout payments this year.
An agreement between the 14 states and the companies gave legal jurisdiction to courts in North Carolina, the nation's leading tobacco state, to decide the issue.

In December, North Carolina Business Court Judge Ben Tennille ruled the companies did not have to make a final, $106 million payment to growers for the final quarter of 2004 and should receive a refund of other payments of about $318 million.

But the state Supreme Court ruled Friday that Tennille was mistaken, writing in the opinion that the tobacco companies "must actually assume the burden of (the buyout) before being relieved of their obligations to the Phase II Trust."

The ruling affected 80,000 tobacco growers and more than 300,000 tobacco quota holders in North Carolina, Kentucky, Tennessee, South Carolina, Virginia, Georgia, Ohio, Indiana, Florida, Missouri, West Virginia, Alabama, Maryland and Pennsylvania.

Associated press writer Emery P. Dalesio and Messenger-Inquirer reporter James Mayse contributed to this report.

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